



## The SA Bullion Gold Report Third Quarter 2018

**Analyst:** Hilton Davies  
**Date:** 8 October 2018

**Table 1:** Gold Performance to 30 September 2018 (% per annum)<sup>1</sup>

|                   | Quarter <sup>2</sup> | 1 Yr | 3 Yr | 5 Yr | 10 Yr | Since<br>31/12/1999 |
|-------------------|----------------------|------|------|------|-------|---------------------|
| Gold in US Dollar | -5.2                 | -7.6 | 2.1  | -2.2 | 3.0   | 7.8                 |
| Gold in Rand      | -3.4                 | -3.6 | 2.0  | 4.4  | 8.6   | 12.7                |
| Gold in Euro      | -5.6                 | -6.8 | 0.6  | 0.7  | 5.0   | 6.9                 |

<sup>1</sup> Based on LBMA PM Fixes.

<sup>2</sup> Not annualized for periods of less than one year

**Table 2:** Quarter-End Gold Prices and Exchange Rates<sup>1</sup>

|             | Gold in US\$/<br>oz | R/\$ rate | Gold in R/<br>oz <sup>2</sup> | \$/€ rate | Gold in €/oz |
|-------------|---------------------|-----------|-------------------------------|-----------|--------------|
| 30 Sep 2008 | 884.50              | 8.28      | 7,324.23                      | 1.42      | 624.03       |
| 30 Sep 2009 | 995.75              | 7.58      | 7,545.29                      | 1.46      | 682.62       |
| 30 Sep 2010 | 1,307.00            | 6.97      | 9,115.41                      | 1.36      | 958.35       |
| 30 Sep 2011 | 1,620.00            | 8.07      | 13,068.70                     | 1.34      | 1,204.73     |
| 30 Sep 2012 | 1,776.00            | 8.26      | 14,671.89                     | 1.29      | 1,377.27     |
| 30 Sep 2013 | 1,326.50            | 10.19     | 13,519.96                     | 1.35      | 980.41       |
| 30 Sep 2014 | 1,216.50            | 11.30     | 13,749.86                     | 1.26      | 964.40       |
| 30 Sep 2015 | 1,114.00            | 14.17     | 15,788.27                     | 1.12      | 996.02       |
| 30 Sep 2016 | 1,322.50            | 13.79     | 18,242.50                     | 1.12      | 1,179.93     |
| 30 Sep 2017 | 1,283.35            | 13.53     | 17,363.72                     | 1.18      | 1,088.02     |
| 30 Sep 2018 | 1,185.40            | 14.11     | 16,731.92                     | 1.17      | 1,013.99     |

Note 1: Gold prices in US\$ and € are LBMA PM Fixes.

Note 2: Gold price in Rand from Rand Refinery.

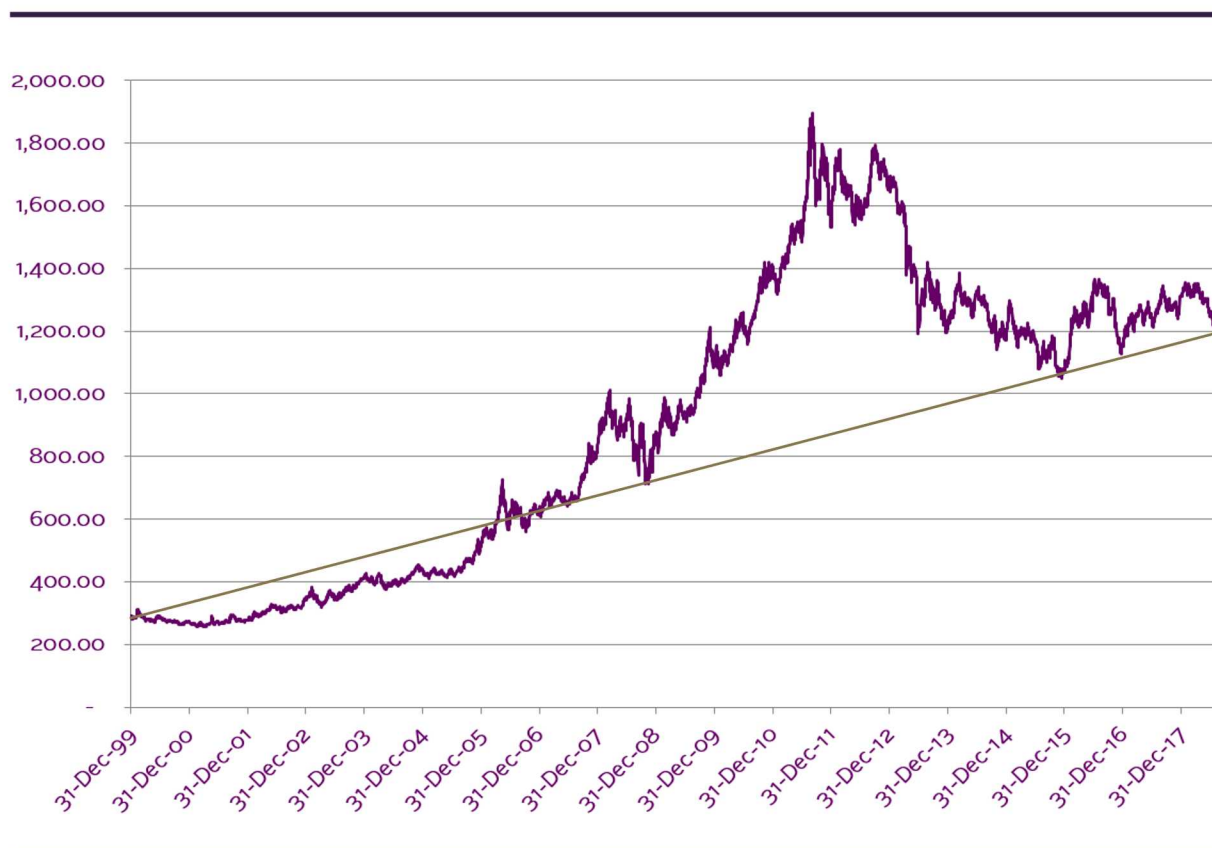
Note 3: Previous quarter-end gold prices were \$1,250.45, R17,323.96 and €1,074.14.

Note 4: Gold prices as at 31 December 1999 were \$290.25, R1,785.04 and €289.09.

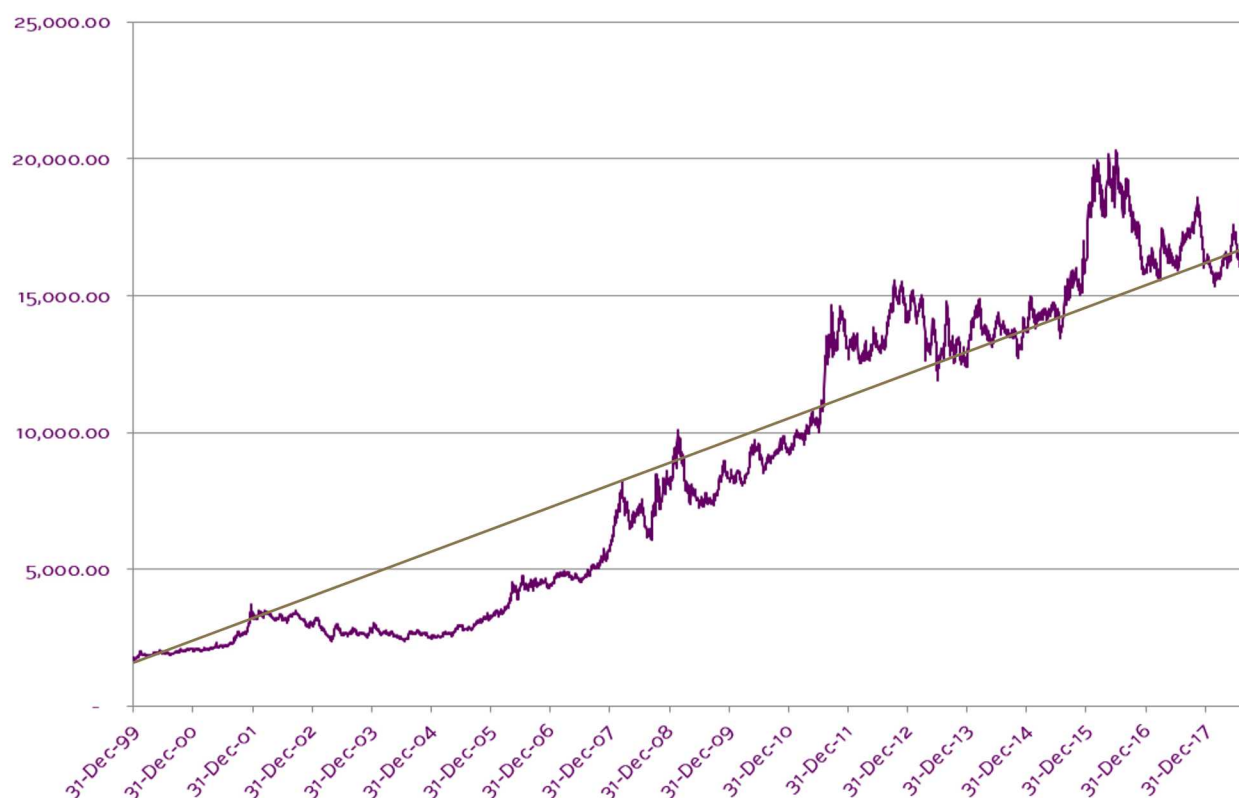
Note 5: Gold prices as at 8 October 2018 were \$1,203.80 and R17,744.01

**Table 3:** Calendar Year Performance of Gold

|                   | %<br>US Dollar | %<br>ZA Rand | %<br>Euro |
|-------------------|----------------|--------------|-----------|
| 2008              | 4.3            | 41.1         | 9.7       |
| 2009              | 25.0           | -0.4         | 21.1      |
| 2010              | 29.2           | 16.1         | 38.2      |
| 2011              | 8.9            | 33.0         | 12.6      |
| 2012              | 8.3            | 13.6         | 6.2       |
| 2013              | -27.3          | -11.8        | -30.3     |
| 2014              | 0.1            | 10.4         | 13.4      |
| 2015              | -11.4          | 19.1         | -1.1      |
| 2016              | 7.7            | -2.5         | 13.3      |
| 2017              | 12.2           | 1.3          | -2.6      |
| 2018 year to date | -8.2           | 4.0          | -6.1      |

**Figure 1:** 21st Century Chart of Gold Price in US Dollar (LBMA PM Fix)

**Figure 2:** 21st Century Chart of Gold Price in ZA Rand (Rand Refinery First Pricing)



### Gold Price Action

Following a very strong second quarter in Rand, gold had a poor quarter in every currency. The last one-year returns have been poor. Over 10 years gold has strongly outperformed cash, and since the turn of the century gold as an investment has been excellent.

### Preface

The United States, its financial markets, and its currency are on the cusp of change. The wagon with its pioneers on board has crested the front range, but what lies ahead are not plains.

In our Second Quarter 2009 report (see: [www.sabullion.co.za](http://www.sabullion.co.za)) we wrote that the US must “inflate or die” and that “reflation” must continue unabated. For nearly 10 years that has been the case. That is all about to change.

## The Cycle

One of the world's largest investment banks, Lehman Brothers, collapsed in late 2008. This was the final straw that broke the camel's back, and precipitated the abrupt ending of the previous up cycle. In the 10 years following, we have witnessed most of the completion of the next cycle.

The classic Debt Deflation Cycle is distinguishable for its stages – as we have extensively analysed in past reports. The current 10-year cycle that we are in has been an excellent model of the classic cycle. Consider the following:

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|                         |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|-------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Depression:             | As followed the collapse of Lehman's and the Sub-Prime Mortgage Crisis that precipitated the Global Financial Crisis commencing late 2008. Stock markets collapse, interest rates are slashed even to zero percent, monetary policy doesn't work normally and the economy backslides.                                                                                                                                                                                                                                       |
| Deleveraging:           | As evident commencing in 2009. The Private Sector (households and business) frantically reduce debt, negatively impacting house prices, stocks and business growth.                                                                                                                                                                                                                                                                                                                                                         |
| Extraordinary Measures: | In the US and similarly in most of the Advanced Countries, dramatic monetary and fiscal policies were put into effect in 2009 and for the next few years following. Extraordinary measures include Quantitative Easing (to lower long rates and to inject liquidity into the financial system) and the outright purchasing of the most risky assets in order to move financial risk from the banks to the state ("Socialisation of risk"). Fiscal measures included the dramatic cutting of tax rates and deficit spending. |
| Normalisation:          | In the US and worldwide this phase presented itself around 2012 to 2014. In this phase debt growth picks up causing house and stock prices to rise, Private Sector Debt is low and easy to service.                                                                                                                                                                                                                                                                                                                         |
| Bubble Phase:           | This has been the period of approximately 2015 to the present. The Private Sector is hungry for debt and gears up. Asset prices rise fast and people make leveraged investments. The public is bullish and begins to believe that things will only get better, in perpetuity. The stock market gets new entrants. Stock prices are high relative to traditional measures. Business is doing well and unemployment is low. The central banks begin to whisper about raising interest rates.                                  |
| The Top:                | Central banks tighten.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |

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## **Reflation**

### What is reflation?

Reflation is a package of coordinated stimulus efforts conducted by a government with the objective of lifting an economy back to its long term trend level following a dip. These stimulus efforts are largely monetary or fiscal in nature.

Monetary stimulus comes from central bank interventions – in the case of the United States of America - Federal Reserve Board (“Fed”) interventions. Monetary stimulus chiefly entails reducing interest rates and injecting money into the financial system.

Fiscal stimulus flows from Government via the Legislative and Executive Branches, i.e. Congress and the President, by way of amended tax laws that reduce taxation and thereby leaving more money in the hands of the private sector; and by way of Deficit Spending, which causes an expansion of the National Debt.

### Has there been reflation and if so, has it worked?

Definitely. The actions of the Federal Reserve and the fiscal authorities have raised stock markets, lifted the US economy and improved employment conditions. We explained the Wealth Effect and its transmission process in our Fourth Quarter 2012 report (see [www.sabullion.co.za](http://www.sabullion.co.za)). Slowly but surely the process worked, where rising asset prices eventually translated into business spending and employment. Note the following:

At end-Feb 2009 the Dow Jones Industrial Average (an index of 30 major US corporations listed on the New York Stock Exchange and NASDAQ) was at 7,062. Today it is at 26,400 (source: Dow Jones).

The US economy contracted in 2009 with GDP growth at -2.5%. In 2017 the US economy expanded 2.2%.

Official Unemployment (U-3 Rate) has dropped from 10% in October 2009 to 3.7% presently (source: US BLS).

## **A Brief Note on Liquidity**

The Bank for International Settlements (or “BIS”) is in effect the central bank of central banks. Its concern is the monetary and financial stability of the world.

The BIS uses the term “Global Liquidity” to refer to the ease of financing in global financial markets. Credit is among the key indicators of global liquidity and the focus of the global liquidity indicators of the BIS.

The BIS says: “Unusually rapid changes in outstanding credit are associated with the build-up of vulnerabilities, with potential implications for financial stability”. History convinces us of this point, and holding the views that we do, we felt this point is worth emphasizing here.

## **Liquidity and the State of Play**

It is important to know that the Fed and other central banks only control interest rates at the short end. They do not control long term interest rates. That control resides with the markets i.e. the collective actions and views of all participants. These points are true – except in exceptional circumstances.



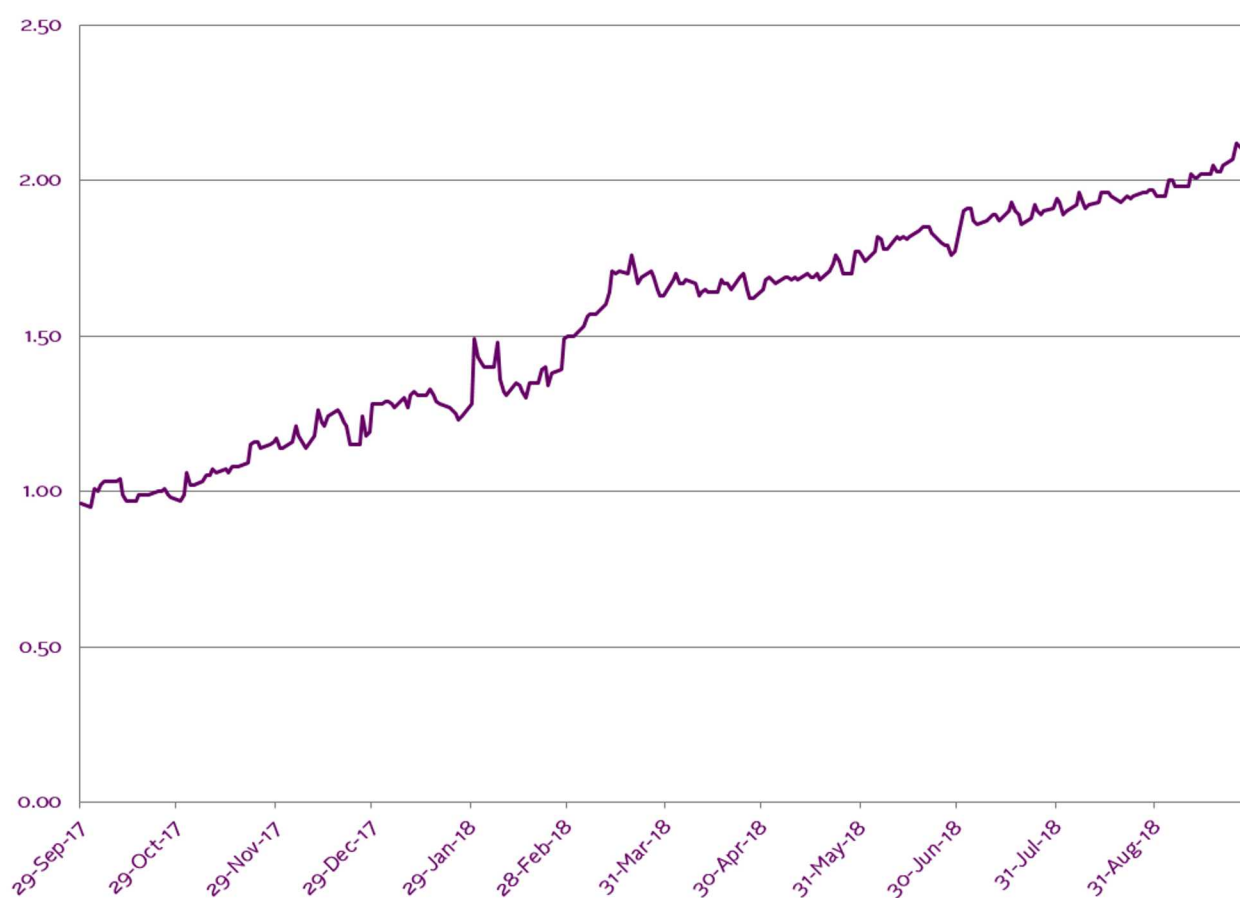
We are in an era that is similar to that of the late 1930s. Only in the late 1930s and in the current time have interest rates gone to zero percent and still been ineffective, resulting in the deployment of some other extraordinary monetary policy. The other policy has been Quantitative Easing, or “QE”. This policy has entailed the purchasing of financial assets by the Fed and other central banks. The objective has been to buy these assets by overpaying for them, thereby driving down yields and in so doing manipulate long term rates downwards.

In order to carry out their QE intentions, the major central banks – the Fed, the European Central Bank (“ECB”) and the Bank of Japan (“BoJ”) have bought assets around the world to a value of approximately \$15 trillion. In 2017 alone, the big central banks injected \$1.5 trillion into the financial system by way of QE.

In recent times short term rates have been controlled by the Fed, and long term rates have been controlled by the ECB and BoJ. In 2015 the Fed ended its QE3 programme leaving the setting of long term interest rates to the ECB and BoJ who have continued with their QE programmes. That however is about to change. The ECB is scheduled to end its QE programme altogether in 2019.

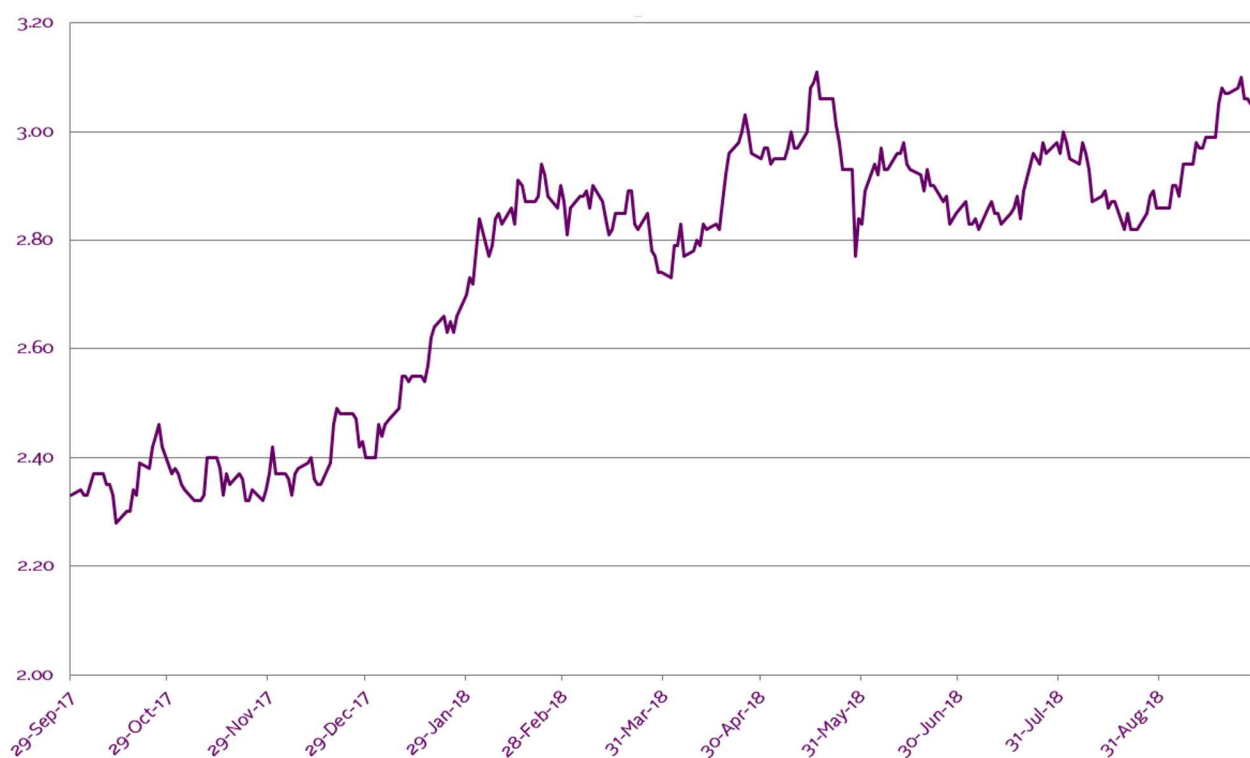
In 2018 to date, the big central banks have conducted QE to the extent of approximately \$125 billion – down 90% on 2017. Additionally, the Fed is shrinking its balance sheet by “rolling off”, where it allows securities to mature and cease to be. Global liquidity is shrinking fast and tightening is becoming the new flavor in town. Already the effect has been seen in short rates that have almost doubled, from around 1% to around 2% and long rates have risen in a year from around 2.2% to around 3.2%. See charts.

**Figure 3:** US Treasury One-Month Bill Yield



Source: [www.fred.stlouisfed.org](http://www.fred.stlouisfed.org)

**Figure 4:** US Treasury 10-Year Note Yield



Source: [www.fred.stlouisfed.org](http://www.fred.stlouisfed.org)

### Effects of Tightening Liquidity Conditions

Tightening liquidity spells very bad news for global asset markets. The quickest winners due to QE have become the quickest losers due to tightening. Treasuries have reacted fast. Yields have risen quickly and the securities have lost value. QE drove performance in corporate bonds and emerging market debt. The reverse is now playing out. This is classic Mean Reversion.

Higher US interest rates have translated into a stronger Dollar, and together these have roiled developing markets. Investors have worried about the ability of Developing Nations to service their Dollar-denominated debt, and as a result, have re-priced securities and currencies of certain, more vulnerable Developing Nations. A quick review of risk ratings of the most vulnerable countries as formulated by Fitch will confirm suspicions due to recent currency movements:

**Table 4:** Emerging Market Countries Vulnerabilities to Monetary Policy Tightening

| Rank | Country      | Fitch Rating | Rating Trend | Sovereign Risk |
|------|--------------|--------------|--------------|----------------|
| 1    | Ukraine      | B-           | Up           | High           |
| 2    | Argentina    | B            | Up           | High           |
| 3    | Brazil       | BB-          | Down         | Medium         |
| 4    | Turkey       | BB+          | Down         | High           |
| 5    | South Africa | BB+          | Down         | Medium/Low     |

Source: Fitch

## Take-Aways and Last Words

- We are nearing the end of the current cycle and all asset prices (stocks, bonds, properties) are very vulnerable;
- Emerging Market currencies (including Rand) are very vulnerable to a rising US Dollar.

This is a time to be defensive in terms of overall exposure to stocks, bonds and properties. This is a time to be cautious in terms of exposure to emerging currencies like the South African Rand. This is a time to hold Dollar-denominated gold bullion and US Dollar currency.

## SA Bullion News

### New Online Functionality

We are delighted to announce that we have developed an online portal for you, our customer, whether you be an Investor or Financial Advisor. This portal enables you to login via our secure website to get a live view of your investments with us. Up to date gold holdings, cash in bank, transactions, and more, are all available with a few clicks.

You will shortly receive an email from us indicating the process to be followed for logging in, and your unique login credentials that ensure the confidentiality of your business with us.

This project has been difficult, costly and onerous. My thanks go to our IT services company Silicon Overdrive, who have been tremendous, and to our very own Operations Director, Imran O'Brien, who has been titanic in his leadership of this project.

### New Line of Business

For 12 years SA Bullion has offered a custody service for gold bullion holdings. In support of this service, the company conducts dealing on behalf of clients on both ends – i.e. buying and selling.

It has long been an aspiration of the firm to broaden its scope as a purveyor of gold, to include a retail offering. In this space the firm would simply be a retailer, selling gold to customers and buying gold from the public. We are pleased to announce that we have entered into an agreement with Rand Refinery Limited and have been operational in this new line of business for two months. In this time we have done more than R30 million of new business!

For information regarding our retail proposition please visit our website and click on Buy/Sell Krugerrand.



Hilton Davies  
8 October 2018